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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

NATIONAL GROCERY COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on October 21, 1937.

OPINIONS BELOW

The opinion of the Board of Tax Appeals, together with the dissenting opinion (R. 17–32), is reported in 35 B. T. A. 163. The opinion of the Circuit Court of Apeals (R. 172–180) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Third Circuit was entered on October 21, 1937 (R. 180). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals for the Third Circuit departed from the accepted and usual course of judicial proceeding in its decision and opinion concluding that there was no evidence to sustain the determination of the Board of Tax Appeals that respondent was availed of during the taxable year for the purpose of preventing the imposition of the surtax upon its sole stockholder.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 23–28.

STATEMENT

The Commissioner determined that in the taxable year ended January 31, 1931, the respondent had permitted its profits to accumulate beyond the reasonable needs of its business instead of being distributed, which he construed as prima facie evidence of the purpose to prevent the imposition of the surtax upon its stockholder, and accordingly determined a deficiency in the amount of $477,360.68 (R. 14).

The Board sustained this determination (R. 33). In its opinion, the Board stated that it concluded from the evidence before it that the respondent's accumulations of earnings in the taxable year were far in excess of the reasonable needs of the corporate business (R. 22–23); that the evidence did not overcome the resultant statutory presumption; the respondent was availed of for the interdicted purpose during the fiscal year ended January 31, 1931 (R. 24).

The findings of the Board may be summarized as follows (R. 18–21):

Since 1908 the respondent corporation, all of whose shares were beneficially owned by its organizer, one Kohl, had operated a chain of grocery stores on a "cash and carry" basis. Its annual profits in the fiscal years ended January 31, 1923, to January 31, 1931, had been in excess of $500,000, and for the last four of these $818,043.54, $870,144.92, $806,507.32, and $786,466.98, respectively, and in these years it had operated 715, 782, 799 and 815 stores, respectively. In the same period it had paid Kohl a salary of $2,000 a week. For a long time the respondent had invested its surplus profits in stocks and bonds in order to obtain a greater return therefrom than would have been possible from bank deposits and with the thought in mind of realizing cash thereon for the purpose of expanding its chain of grocery stores at any time

desired. The only dividends it had paid up to the end of the taxable year were two of $25,000 each, one in 1917 and one in 1918. On the other hand, the respondent had advanced $394,100 to Kohl up to January 26, 1925, on notes bearing interest, although no interest had ever been charged or paid thereon. Thereafter it made further loans to him on notes bearing no interest, so that at the end of the taxable year it had loaned him $610,000. In that year the respondent loaned Kohl $140,000, $40,000 of which was to enable him to acquire a house in Florida, and $100,000 to make a personal charitable contribution. A part of the loans was canceled in subsequent years by dividends declared after the end of the taxable year, a balance of $424,000 remaining unpaid as late as April 23, 1936. The respondent's balance sheet for the fiscal years ended January 31, 1928, to January 31, 1931, inclusive, shows as follows:[1]

[1] The tabulation following is a part of the respondent's balance sheet, 1907 to 1935 (Exhibit 6, R. 136–137).

	Fiscal years ended—			
	1/31/28	1/31/29	1/31/30	1/31/31
ASSETS				
Cash	$659,734.40	$890,397.59	$1,332,332.28	$1,405,961.04
Notes receivable	424,100.00	460,000.00	470,000.00	610,000.00
Accounts receivable	1,888.82	3,975.19	26,816.37	3,220.85
Inventories	2,615,057.67	2,917,716.55	3,189,396.72	2,812,939.16
Mortgage	59,000.00	59,000.00	59,000.00	59,000.00
Bonds	256,114.76	96,820.30	59,435.00	313,291.27
Stocks	2,169,687.62	2,318,074.13	2,720,283.07	2,676,061.47
Other	6,236.39	7,425.08	10,150.89	20,686.18
Deferred	33,338.64	25,685.23	31,875.79	29,687.74
Permanent	1,542,129.00	1,501,193.83	1,345,976.63	1,177,489.43
Total	7,767,287.90	8,280,287.90	9,245,266.75	9,108,437.14
LIABILITIES				
Notes payable and mortgages	1,008,750.00	700,000.00	790,000.00	
Accounts payable	258,889.61	270,318.54	371,121.96	269,140.49
Accrued	7,742.15	7,385.56	19,757.11	7,411.70
Reserve income tax	93,933.45	72,035.56	52,592.97	51,330.42
Reserve insurance	417,797.77	491,032.34	565,970.45	641,588.99
Capital stock and surplus	5,980,174.92	6,739,515.90	7,445,824.26	8,138,965.54
Total	7,767,287.90	8,280,287.90	9,245,266.75	9,108,437.14

The fair market value of the securities owned by the respondent on January 31, 1931, was $2,125,434.50, as against the cost of $2,989,452.74, a difference of $864,018.24. In conclusion, the Board found that, during the fiscal year ending January 31, 1931, the respondent was availed of for the interdicted purpose.

The Circuit Court of Appeals for the Third Circuit, in an opinion written by Judge Buffington, Judge Biggs dissenting, reversed the Board's decision, on the ground that the Board had relied solely on the report of a revenue agent and other information furnished to the Commissioner; that the Board had failed to pass on what the court considered the

uncontradicted proof of the respondent, and that this uncontradicted testimony showed that the business needed the surplus which respondent maintained. Without entering into further details, it limited itself to holding that the Board had before it no proof, substantial or otherwise, to support the imposition of the "penal tax."

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred—

1. In finding, concluding, and holding that the Board of Tax Appeals had failed to pass upon what the court considered to be the uncontradicted proofs made by the respondent, and that, when this was called to the Board's attention, it had failed to call witnesses but had based its finding solely upon a report made to the Commissioner by a revenue agent of an *ex parte* investigation made by him, which is not in evidence, and upon certain subsequent information furnished the Commissioner, the nature of which is not disclosed by the evidence.

2. In failing to remand the proceeding to the Board for a rehearing, if it is true that the Board was guilty of such an arbitrary disposition of the issues.

3. In usurping the power of administrative decision by finding the facts from conflicting evidence, determining the issue itself, and substituting such determination for that of the administrative body.

4. In rejecting a finding of fact made by the Board that, in the fiscal year ended January 31, 1931, the respondent's gains and profits were permitted to accumulate beyond the reasonable needs of its business, where it does not appear that the evidence, with every reasonable inference that may be drawn therefrom in the petitioner's favor, is insufficient to sustain such finding, and in making its own contrary finding upon the basis of testimony of certain facts which, standing alone, would support such contrary finding; and, in so doing, failing to consider evidence of an array of facts, which, together with proper inferences to be drawn therefrom, discounts the testimony which the court relied upon and supports the finding of the Board.

5. In rejecting a finding of fact made by the Board that the respondent has failed to overcome the statutory presumption arising from the fact that it had permitted its gains and profits to accumulate beyond the reasonable needs of its business, where it does not appear that the evidence, with every reasonable inference that may be drawn therefrom in favor of the petitioner, is insufficient to sustain such finding.

6. In rejecting a finding of fact made by the Board that the respondent was availed of for the interdicted purpose, where it does not appear that the evidence, with every reasonable inference that

may be drawn therefrom in the petitioner's favor, is insufficient to sustain it.

6. In entering a judgment the effect of which is either to expunge the deficiency determined by the Board or to require the Board to do so.

7. In reversing the Board's order of redetermination of the deficiency in the tax of $477,360.68.

REASONS FOR GRANTING THE WRIT

In its review of the decision of the Board of Tax Appeals, the court below has so far departed from the accepted and usual course of judicial proceeding as to call for an exercise of this Court's powers of supervision.

Specifically, the court below wrongfully charged the Board (a) with having neglected to consider what the court considered to be the uncontradicted proofs given by respondent; (b) with having based its action solely on the revenue agent's report and other information furnished to the Commissioner, none of which was in evidence; (c) with having failed itself to determine whether the profits were accumulated beyond the reasonable needs of the business, and with having failed to make the finding required by the statute, though the dissenting members called attention to this, but with having instead construed the revenue agent's report and the other information furnished the Commissioner as *prima facie* evidence of a purpose to prevent the

imposition of a surtax upon respondent's stockholder, and with acting on this allegedly foundationless *prima facies* in drawing the conclusion that "We [the Board] are also of the opinion that the evidence of record does not rebut the prima facie presumption created by the statute" (R. 23).

Further than this, instead of remanding the case, so that the Board could consider the respondent's evidence which it had allegedly neglected on the first hearing, the court below, while ostensibly reviewing the facts to determine whether there was any evidence to sustain the Board's findings of an accumulation beyond the reasonable needs of the business and of the interdicted purpose, proceeded to find the facts from conflicting testimony and to determine the issues itself contrary to the finding of the Board. Moreover, in so doing, it culled from the evidence certain facts, which, standing alone, would support such a contrary finding and, by the same token, failed to consider an array of facts, which, together with proper inferences to be drawn therefrom, not only discounts the testimony the court relied upon, but amply justifies the finding of the Board.

The only issue before the court was whether the evidence, with the inferences reasonably to be drawn therefrom in petitioner's favor, supported the findings and judgment of the Board of Tax Ap-

peals against respondent.[2] What the court should have done, but did not do, was to review all the evidence in the case, to determine whether there was any evidence which, with the inferences favorable to petitioner reasonably to be drawn therefrom, supported the Board's judgment in his favor. Although the court said that it had found no proof before the Board which supported its determination, actually it proceeded with the case as though the findings and decision had been in the *respondent's* favor, and selected from the evidence and discussed such facts as would have supported such a judgment. Thus the court has usurped the power of administrative decision and substituted its judgment for that of the administrative body.

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1. The court based its result in large part upon a grave misinterpretation of the Board's opinion. The court said that the Board had relied solely on

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[2] Whether the petitioner permitted gains to accumulate beyond the reasonable needs of its business, and whether the petitioner was availed of for the purpose of preventing the imposition of a surtax upon its shareholders through the accumulation of gains, are clearly questions of fact, upon which the Board's findings are conclusive if supported by the evidence. *United Business Corp.* v. *Commissioner*, 62 F. (2d) 754 (C. C. A. 2d), certiorari denied, 290 U. S. 635; *United States* v. *R. C. Tway Coal Sales Co.*, 75 F. (2d) 336 (C. C. A. 6th); *A. D. Saenger, Inc.* v. *Commissioner*, 84 F. (2d) 23 (C. C. A. 5th), certiorari denied, 299 U. S. 577; *R. & L., Inc.* v. *Commissioner*, 84 F. (2d) 721 (C. C. A. 5th); *Commissioner* v. *Fisher & Fisher*, 84 F. (2d) 996 (C. C. A. 2d); *Commissioner* v. *Cecil B. De Mille Productions*, 90 F. (2d) 12 (C. C. A. 9th), certiorari denied, October 11, 1937; *Almours Securities, Inc.* v. *Commissioner*, 91 F. (2d) 427 (C. C. A. 5th), certiorari denied, January 10, 1938.

the revenue agent's report and other information furnished to the Commissioner, and construed it as *prima facie* evidence of respondent's purpose to prevent imposition of a surtax upon its shareholders, that the Board had not itself determined whether the profits were permitted to accumulate beyond the reasonable needs of the business or made a finding to this effect.[3] In these statements, the court erred. The error is important because it was in large part due to this analysis that the court disregarded the true basis of the Board's decision and much of the evidence introduced before and considered by the Board. Although the Board did set out the Commissioner's deficiency notice, which in

[3] Since the court stated that the "basic thing was for the Board to itself determine whether the 'profits are permitted to accumulate beyond the reasonable needs of the business'" and then observed that "the Board made no such finding as the Act requires" (R. 177), apparently the court felt that the finding omitted by the Board was that pertaining to accumulation beyond the reasonable needs of the business. But the court then stated the Board failed to make the required finding "notwithstanding its attention was called thereto in the dissenting opinion" (R. 177). Examination of the paragraph quoted from Member Mellott's dissent (R. 25) discloses that he had reference to the finding of the ultimate purpose to escape surtaxes rather than the intermediate fact of accumulation beyond the reasonable needs of the business. Moreover, he was merely calling attention to the Commissioner's failure explicitly to make this finding. He decided that he would not concur in the Board's finding, but by no means implied that the Board did not make such a finding.

Whichever finding it was that the court thought had not been made by the Board, it is apparent that the Board made both findings, and each instance upon its own inferences from evidence introduced before it. See *infra*, pp. 12–13.

turn advised the taxpayer that, upon the basis of information furnished that office the Bureau approved the conclusion of the revenue agent that there existed an accumulation of profits beyond the reasonable needs of the business, the Board nowhere indicated that it was relying on the revenue agent's report or on other information furnished the Bureau, and it certainly negatived any suggestion that the deficiency notice and its contents constituted the sole basis of its decision. It is abundantly clear that though the Board may have arranged its opinion "inartistically" (cf. R. 180), it did determine for itself and find as a fact, upon the evidence before it, that the profits had been accumulated beyond the reasonable business needs (R. 22–23); that it then examined the other evidence and determined therefrom that the statutory presumption of the purpose to prevent surtaxes had not been rebutted and indeed had been corroborated (R. 23–24), and that it concluded with an express finding of the interdicted purpose (R. 24).

The Board concisely summed up the evidence on which it primarily relied in reaching its conclusion that the accumulation of profits was beyond the reasonable needs of the business. It adverted to several factors in the evidence (R. 22–23): (a) Since the time prior to 1922 when the taxpayer began to invest in stocks and bonds its holdings have greatly increased. There was also, up to 1929, a very large increase in the market value of the securities acquired. (b) Since 1929, the petitioner has not greatly expanded its grocery business.

(c) Its large profits have not been distributed as dividends but have been mostly invested in securities. (d) Taxpayer's balance sheets for the beginning and the end of the taxable year were set out. (Each shows current assets far in excess of actual liabilities. Indeed, each shows cash on hand alone as far in excess of actual liabilities.) (e) Taxpayer's actual surplus at January 31, 1931, was $7,938,965.54. (f) The Board disposed of the taxpayer's contention that the surplus was of benefit in obtaining credit at banks and in enabling it to purchase merchandise at low prices, finding from the evidence that the taxpayer's credit had been excellent and that it did not obtain lower rates of interest because of a large investment in stocks and bonds.

Only then did the Board turn to a consideration of whether the evidence rebutted the statutory presumption attending this finding of the Board, concluding that it did not, since the evidence showed that Kohl personally needed some of the profits in that year, had prior thereto borrowed $470,000 from the company without paying interest, and had increased his borrowings by an additional $140,000 in the taxable year with the result that there was an escape of the surtax upon (at least) that amount (R. 23–24).

2. Instead of affirming the Board's decision on the basis of these facts to which the Board adverted and also on the basis of other evidence in the record (see *infra*, p. 16 *et seq.*), the court proceeded to decide the issues of fact itself.

Instead, the court dwelt at length upon the history of the respondent's "cash and carry" business, as testified to by Kohl, and upon his testimony and that of other witnesses called by the taxpayer to the effect that in their opinion the accumulations were reasonably necessary (1) in the expansion of its grocery business, (2) in the conduct of that business, and (3) because of the depreciation in the value of its investments during the depression. Upon the basis of such testimony, the court reversed the Board's findings of fact.

The signal objection to the court's approach is the fact that in effect it disposed of the case in accordance with its own inferences from the evidence. The opinion testimony of respondent's witnesses at most pointed to a different result from the evidence discussed by the Board, and should not have been given controlling weight by the court. It is only the trier of the facts who may choose between conflicting inferences which arise from different facts. "It is the function of the Board to weigh the evidence and declare the result." *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U. S. 37, 40.

Moreover, in view of other evidence in the record which was not specifically discussed by the Board, it can not be said that the evidence recited by the court was truly "uncontradicted." The Government did not formally introduce opposing opinion testimony, but this was not necessary; testimony may carry its own refutation or modification, or

may be explained away by the answers of the witness himself on cross-examination. Surely the Board was not bound by the mere denial of the interdicted purpose. Besides, the development in the record of the actual status of respondent's business consists largely of joint exhibits. Several of the exhibits formally introduced by respondent were prepared by the Government (R. 56), offered at the Government's request (R. 57, 59), or with the Government's prior approval (R. 48, 53, 56), in a joint effort to facilitate the conduct of the trial.

In culling from the record testimony which, standing alone, tends to support its finding, the court overlooked the following array of facts which, together with proper inferences to be drawn therefrom, discounts the testimony the court relied upon, and amply justifies the finding of the Board. These facts indicate that a sizable portion of respondent's profits for the taxable year, shown on its books (after deducting Kohl's salary of $104,000 and its income taxes of $103,616.60) as $682,550.38,[4] could have been declared as a dividend without curbing in the slightest the reasonable needs of the business, and are as follows:

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[4] The net taxable income, upon which the tax was based, as shown in Exhibit A, attached to the respondent's petition filed with the Board, was $954,645.62. The correctness of this figure is not in controversy. The Board, in its finding (R. 18), used the book figure of $786,466.98, which was apparently derived from the books, and may represent a slight arithmetical error of $300 in adding $682,550.38 and $103,616.60, the correct sum of which is $786,166.98.

(1) The accumulations were not needed to acquire new stores. Respondent's policy was merely to rent stores, not to purchase the real estate on which they were located (R. 68). Only $5,000 was needed to acquire and finance each new store (R. 68–69). During the taxable year respondent paid off all its bank loans, $790,000, decreased its accounts payable by more than $100,000 and its accrued expenses by more than $12,000 (Exhibit 6, R. 136–137). Yet it had left a working capital of $4,500,000, according to its witness Field (R. 86), and though his mode of estimate is not set out, his figure is, if erroneous at all, too small.[5] Since re-

[5] Field stated that the working capital at the end of 1930 was $3,700,000-odd, and at the end of January 1931 was $4,500,000.

The normal signification of "net working capital" is the excess of current assets over current liabilities. Paton, Accountants' Handbook (2d ed. 1932), p. 19. The following computation of working capital is based on Exhibit 6, R. 137.

	Year Ending—	
	1/31/30	1/31/31
Current Assets:		
Cash	$1,332,332.28	$1,405,961.04
Notes Receivable	470,000.00	610,000.00
Accounts Receivable	26,816.37	3,220.85
Merchandise Inventory	3,189,396.72	2,812,939.16
Mortgage	59,000.00	59,000.00
Bonds and stocks	2,779,718.07	2,989,452.74
Total current assets	7,857,263.44	7,880,573.79
Current Liabilities:		
Notes Payable	790,000.00	
Accounts Payable	371,121.96	269,140.49
Accrued Expenses	19,757.11	7,411.70
Total current liabilities	1,180,879.07	276,552.19
Working capital	6,676,384.37	7,604,021.60

spondent had $1,405,961.04 cash in the bank, and current liabilities of only $276,552.19 (R. 137), it is obvious that respondent could have paid its current liabilities in full in cash, could in addition have acquired and financed 100 additional stores with cash, and still have had left a working capital of at least $3,723,447.81, of which $629,408.85 would have been in cash.

(2) The accumulations were not needed in the respondent's grocery business. The testimony considered by the court with respect to this point is even more vague than the testimony regarding expansion. The court quoted Mr. Field's references to "panicky conditions," to the company's turnover, to the necessity for "a considerable working capital and a surplus to meet any additional losses they might encounter" (apparently on inventory).

Even if account is taken of the depreciation in the value of the stocks and bonds, and their book value is replaced by fair market value (which, according to respondent's own estimate (R. 61–62, 146), was $2,859,217.25 as of January 31, 1930, and $2,125,434.50 as of January 31, 1931), the working capital is still seen to be $6,755,883.55 on January 31, 1930, and $6,740,003.36 on January 31, 1931, much higher than Field's figures.

Field may have obtained his figures by eliminating all consideration of stocks, bonds, and mortgages, for, upon that hypothesis, the working capital figures become $3,837,666.30 on January 31, 1930, and $4,555,568.86 as of January 31, 1931. There seems to be no warrant, however, for excluding from "current assets" an item of investments which respondent claims to have acquired merely in order to have on hand an equivalent of cash.

In discussing respondent's working capital needs, it may first be noted that its "cash and carry" system rendered unnecessary as large a working capital as would be needed by a concern extending credit. Thus, the apparently formidable item of respondent's purchases, amounting to about $20,000,000 for the year in question (R. 141), is easily explained in view of the fact that respondent turned its stock over *on a cash basis* from 6 to 8 times a year (R. 86). In this way, it received some $25,000,000 from its merchandise sales (R. 7). It is apparent that respondent's working capital far exceeded its reasonable needs. Field's minimum estimate of respondent's working capital on January 31, 1931, as $4,500,000 (which at least takes into consideration depreciation of both merchandise[6] and securities, if it does not actually eliminate them entirely, see *supra,* note 5) bears a ratio to current

[6] The difference between inventory for January 31, 1930, and January 31, 1931, cannot be regarded solely as depreciation. Kohl testified that everything declined in value in 1930 and the petitioner's witness Anna Mullins, the treasurer of the company, testified that there was a "decline" in the petitioner's merchandise inventories from $200,000 to $250,000. If we consider the fact that there was a complete turnover in its capital 6 or 8 times in that year, involving purchases of merchandise in excess of $19,000,000, the inference seems inescapable that much of the decline referred to resulted from new purchases in the course of the year at lower prices rather than from a decline in the value of goods that had been purchased in prior years at higher prices.

liabilities of 15 to 1, while the ratio of cash to such liabilities was 5 to 1. As to Field's fears with respect to additional losses on inventory, if the merchandise had declined in value by half—some $1,400,000—working capital would still be more than ten times as large as current liabilities.

The court below did not rest content with the explanations of respondent's witnesses. It added a word of its own, and regarded the accumulations as respondent's bulwark against fires, earthquakes, floods, ~~etc., were probable in New Jersey, or ex-~~ WARS, STRIKES, BOYCOTTS AND A HOST OF UNFORE—
seen calamities. None of the witnesses stated that the profits were accumulated for these purposes, and none of them even suggested that earthquakes, floods, etc., were probable in New Jersey, or expensive to insure against, or that in 1930 the respondent's labor relations were unsatisfactory. Indeed, with respect to the only fears that the company deemed real and reasonable (fire, burglary, etc.), it had started its own self-insurance reserves (R. 60, 144), which it carried as a liability on its balance sheets (R. 137).

(3) The accumulations were not needed because of the depreciation in value of the securities or inventories. Computations with respect to working capital making allowance for depreciation still show an unreasonable accumulation. Moreover, on cross-examination, both Kohl and the company treasurer explicitly testified that neither an in-

crease nor decrease of the petitioner's assets had anything to do, practically speaking, with the declaration of dividends. (R. 74, 83, 84.) Mr. Field and Mr. Ferguson, bankers called as witnesses by respondent, both testified that the company could have declared a dividend in 1930 of $100,000, without impairing its business (R. 90, 94). Indeed Field testified that respondent's credit was "as good today as it was ten years ago" though in the ~~four~~ FIVE years subsequent to the taxable year in question, the petitioner had paid $400,000 in dividends out of a much diminished net profit of $1,341,382.42 (R. 133) [7]

3. Furthermore, there are other facts in the record, apart from those showing that the accumulations were beyond the reasonable needs of the business, which indicate the respondent's real purpose, and support the Board's result. Thus, the court entirely ignored the consideration that Kohl used the respondent corporation as his "pocketbook." By January 31, 1930, respondent loaned to Kohl $470,-

[7] See the following table derived from Exhibit 4 (R. 133):

Year ending January 31	Net profits after deducting Kohl's salary & Inc. taxes	Dividends declared	Left for accumulation
1931—1/31/32	$535,947.67	$100,000.00	$435,947.67
1932—1/31/33	132,991.35	100,000.00	32,991.35
1933—1/31/34	111,211.91	100,000.00	11,211.91
1934—1/31/35	368,685.50	300,000.00	68,685.50
1935—1/31/36	202,545.99	200,000.00	2,545.99
Total	1,341,382.42	800,000.00	541,382.42

000, partly on demand notes bearing no interest and partly on notes on which no interest has ever been charged or paid (R. 19). During the taxable year, respondent loaned to Kohl an additional $140,000, on notes bearing no interest, in order that he might acquire a house in Florida and make a charitable contribution (R. 20, 24). These loans, taken together with the act that since 1925 respondent has paid Kohl a salary of over $100,000 a year, deductible on its income tax return, indicate that disbursements were made to him upon the basis of his needs and not upon the basis of what the petitioner could reasonably have disbursed. Compare R. 66.

4. Finally, it should be noted that though the court criticized the Board for failing to consider certain evidence which the court deemed persuasive, it reversed the judgment outright instead of remanding the cause so that the Board could consider and weigh that evidence. Clearly the court below has disregarded the injunction of this Court in *Hulburd* v. *Commissioner,* 296 U. S. 300, 306, that the court is "without power to choose between conflicting inferences unless only one was possible, or to try the case *de novo.*" Compare *Helvering* v. *Rankin,* 295 U. S. 123.

CONCLUSION

For the foregoing reasons it is submitted that this is clearly a case of usurpation by an appellate court of the fact-finding function of the Board of

Tax Appeals. It is respectfully urged that this petition for a writ of certiorari should be granted.

GOLDEN W. BELL,
Acting Solicitor General.

January 1938.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 104. ACCUMULATION OF SURPLUS TO EVADE SURTAXES.

(a) If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, there shall be levied, collected, and paid for each taxable year upon the net income of such corporation a tax equal to 50 per centum of the amount thereof, which shall be in addition to the tax imposed by section 13 and shall be computed, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax.

(b) The fact that any corporation is a mere holding or investment company, or that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax.

(c) As used in this section the term "net income" means the net income as defined in section 21, increased by the sum of the amount of the dividend deduction allowed under section 23 (p) and the amount of the interest on obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner.

(d) The tax imposed by this section shall not apply if all the shareholders of the cor-

poration include (at the time of filing their returns) in their gross income their entire distributive shares, whether distributed or not, of the net income of the corporation for such year. Any amount so included in the gross income of a shareholder shall be treated as a dividend received. Any subsequent distribution made by the corporation out of the earnings or profits for such taxable year shall, if distributed to any shareholder who has so included in his gross income his distributive share, be exempt from tax in the amount of the share so included.

Subdivisions (a) and (b) of Section 220 of the Revenue Act of 1924, c. 234, 43 Stat. 253, and subdivisions (a) and (b) of Section 220 of the Revenue Act of 1926, c. 27, 44 Stat. 9, are substantially identical with subdivisions (a) and (b) of Section 104 of the Revenue Act of 1928.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 541. *Taxation of corporation utilized for evasion of surtax.*—Section 104 is designed to discourage the formation or use of a corporation for the purpose of preventing the imposition of surtaxes upon its shareholders, through the device of permitting its gains and profits to accumulate instead of being distributed. If a domestic or foreign corporation is so formed or availed of, it is subject to a tax at the rate of 50 per cent upon its net income in addition to the tax imposed by section 13. However, the additional tax at the rate 50 per cent does not apply for 1928 or any subsequent taxable year if all the shareholders of the corporation include (at the time of filing their returns) in their gross income their entire dis-

tributive share, whether distributed or not, of the net income of the corporation for such year or years. Any amount so included in the gross income of a shareholder shall be treated as a dividend received, and any subsequent distribution made by the corporation out of the earnings or profits for such taxable years shall, if distributed to any shareholder who has so included in his gross income his distributive share, be exempt from tax in the amount of the share so included.

ART. 542. *Purpose to escape surtax:*— Prima facie evidence of a purpose to escape the surtax exists where a corporation is a mere investment company, where a corporation has practically no business except holding stocks, securities, or other property and collecting the income therefrom or investing therein, or where a corporation other than a mere holding or investment company permits its gains and profits to accumulate beyond the reasonable needs of the business. The statutory presumption that a mere holding or investment company is subject to the additional tax imposed by section 104 may be overcome if the corporation can show, either by reason of the fact that it distributed a large portion of its earnings for the year in question, or that its stock was held not by the members of a family or of a small group but by a large number of persons and in comparatively small blocks, or by other evidence, that it was not availed of for the purpose of preventing the imposition of the surtax upon its shareholders.

The business of a corporation is not merely that which it has previously carried on, but includes in general any line of business which it may legitimately undertake.

However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to escape the surtax. When one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance the business of the first corporation. Gains and profits of the first corporation put into the second through the purchase of stock or otherwise may therefore, if a subsidiary relationship is established, constitute employment of the income in its own business. To establish that the business of one corporation can be regarded as including the business of another it is ordinarily essential that the first corporation own substantially all of the stock of the second. Investment by a corporation of its income in stock and securities of another corporation is not without anything further to be regarded as employment of the income in its business.

ART. 543. *Unreasonable accumulation of profits.*—An accumulation of gains and profits is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. It is not intended, however, to prevent reasonable accumulations of surplus for the needs of the business. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business. Distributions made by a corporation shortly after the close of its taxable year shall be taken into consideration in determining the reasonableness of the amount of earnings and profits of the corporation retained by it for such year. Undistributed income is

properly accumulated if invested in increased inventories or additions to plant reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution the business of which is to receive and loan money, using capital, surplus, and deposits for that purpose, undistributed income actually represented by loans or reasonably retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investment of gains and profits is immaterial if they are not in fact needed in the business. It is an unreasonable accumulation of gains and profits by corporations with the purpose of enabling their shareholders to escape surtaxes on such gains and profits which subjects such corporations to the additional tax imposed by section 104. Among other things, the financial condition of the corporation at the close of the taxable year and the manner in which its funds are invested at that date, determine the reasonableness of the accumulations.

For the purpose of section 104 the term "net income" means the net income of the corporation as defined in section 21 increased by the sum of (1) the amount received as dividends and allowed as a deduction by section 23 (p), plus (2) the amount of interest on obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner. The Commissioner, or any collector upon direction

from the Commissioner, may require any corporation to furnish a statement of its accumulated gains and profits, the name and address of, and number of shares held by, each of its shareholders, and the amounts that would be payable to each, if the income of the corporation were distributed. (See section 149 (c).)

Articles 352 and 353 of Treasury Regulations 65 and Articles 352 and 353 of Treasury Regulations 69 are substantially identical with Articles 542 and 543 of Treasury Regulations 74.

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